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Sailing in time of crisis : The European Central Bank's journey towards the European Systemic Risk Board

Abstract

This paper explains how the European Central Bank gained new responsibilities in the European Monetary Union, through the creation of the European Systemic Risk Board. Special attention has been paid 1) to the economic and political features of a systemic crisis, 2) to the institutional position of the ECB in between financial markets and EU political decision-making arenas, and 3) to the role of ideas and actors strategies. This paper bridges thus the International Political Economy and Historical Institutionalism approaches by taking into account all these variables and how they interact.

In a nutshell, the dependant variable of the paper is *the weight of the ECB in EU macro-prudential framework*, the independent variable *is the Bank's position in between financial markets and the political world*, the intervening variable is *the financial crisis* and the mechanism working on the variables is the *strategic selection of ideas.*

Two hypotheses are developed in this paper to explore these variables.

- Since financial crisis are unique events, agents are unsure of their interests and institutional reconfiguration is more likely. The ECB was thus a political entrepreneur, framing first the debate, and then proposing institutional solutions to address the identified problems.
- The Bank was able to diffuse its ideas thanks to its strategic positioning in between financial markets and policy-making and to its tactics of activation/deactivation of the ordo-liberal paradigm.

The main findings of this qualitative research are that 1) systemic financial crisis offer more political space to actor's strategic expansion of competences (IPE approaches), 2) the ECB benefited from its past legacy of credible inflation-fighter (HI approaches) and was able to emancipate itself from this ideal past and 3) politically exploit its credibility and expertise towards financial markets to make its ideas matter.

Finally, the paper is trying to foresee what could be the "spill-over" effect of the ESRB, by looking at the possible future ECB's extension of competences over Commission's macro-imbalances program, EU banking supervision and data collection and diffusion.

Introduction

On the 25th of February 2009, when the De Larosière Group handed his report to the European Commission and to the European Council, its content was hardly a surprise. Indeed, the eight "wise men", who have been asked by J.Barosso to "give advice on the future of European financial regulation and supervision[1]", proposed a framework in which national central bankers and the European Central Bank (ECB) gained considerable responsibilities in macro-prudential supervision *via* the establishment of the European Systemic Risk board (ESRB). Almost two years later, on the 16th of December 2010, the legislation establishing the ESRB entered into force, just before J-C Trichet chaired the inaugural meeting in Frankfurt on the 20th of January 2011. This is a remarkable event : when the ECB was created, such powers were not available for the Bank. Even though the stability of the financial system was part of its missions[2] (as any other Central Bank), the Bundesbank's legacy deprived the ECB of these instruments[3]. Indeed, the German tradition of Central Banking considered that such explicit responsibilities could undermine the main task of a Central Bank, which is price stability. We can thus observe two dimensions related with the creation of the ESRB : 1) there is a break of the ECB's path-dependency towards the Bundesbank, 2) the ECB gained new responsibilities within the European Monetary Union (EMU). This paper seeks to understand *how the ECB gained these new responsibilities*

The theoretical assumption of this paper is based on the importance to consider the ECB as a strategic actor inside a political system (the EMU) to understand the extension of its competences. Indeed, the Bank is independent from the political power but still needs to interact with its partners to fulfill its price stability mission. These interactions are neither neutral nor equal : they are power-related, each actor trying to protect and extend its autonomy vis-à-vis its partners within the system[4]. The gain of new competences by the ECB is therefore not natural : it cannot be only explained by the global redefinition of the place of the Central Banks in the World economy, nor by the Treaty dispositions allowing the ECB to manage the ESRB without any modification and definitely not by the fact that this was the easiest and cheapest solution for the EU.

[1] De Larosière (2009)
[2] Articles 105(5) and 105(6) of the Maastricht Treaty
[3] Dyson (2009), p.141
[4] This approach is heavily influenced by CROZIER Michel and FRIEDBERG Erhard (1977), it can be linked as well with the US tradition of bureaucracy politics.

Instead, the paper argues that the ECB managed to take full advantage of its interface position between the financial markets and the political world. Indeed, the Bank put forward its hard-gained credibility towards financial markets (thanks to its hardliner monetary stance during the ten previous years), and its expertise and first-hand information on market participants and their strategies. This credibility and expertise only matter since the Bank is the only actor in the EMU's political game to possess them at such extent. Again, this is hardly a surprise, as any other Central Bank, they have the monopoly over money-supply and thus a direct access to market participants and their needs. When the crisis hit and worsened in Europe, this kind of information became more and more valuable, as market's liquidity was not anymore a natural assumption but turned into a severe policy problem. In any crisis, the importance of some issues and resources fluctuates and allows actor's reconfiguration within the system. Actors try then to plan strategic moves and to take advantage of two intertwined facts : the plasticity of the system, and the value's variation of political resources[5]. The Bank mobilized then its resources, related to financial markets knowledge and credibility, to take advantage in the macro-prudential supervision debate in Europe. They were however two main obstacles for the Bank's extension of competences : the consequences of this move from strict monetary orthodoxy on its traditional supports (Germany, Finland, Austria, Frankfurt financial actors…) and a credibility risk towards financial markets if they were to fail in their role of market's watchdogs. Even though it is too early to draw any conclusion from the second obstacle (even though, the fact of challenging it shows that the Bank is, in no way, a "shy" actor), the paper claims to demonstrate the mechanism underlying the overcoming of the first obstacle. This mechanism is the careful *activation and deactivation of some component of the ordo-liberal paradigm*[6] by the ECB, legitimizing its place within the ESRB. Indeed, the Bank managed to frame its presence in the Board, thanks to two ideal dimensions emerging during the crisis : the rise of macro-wide issues (economic concerns were much more focused on micro-level of analysis) and the extension of the scope of monetary policy, which should tackle financial instability as well. The Bank could then face the contestation from strict monetary orthodoxies and gain an important share in the macro-prudential supervision[7]

[5] This approach is inspired from, and much more developed, in DOBRY Michel (1992)
[6] For an explanation of ordo-liberalism : Nicholls (1994), Foucault (2004)
[7] It is worth to notice that the Bank was already defending the role of central banks in matter of supervision when the model of integrated regulator was challenging them, cf ECB (2001)

In a nutshell, the dependant variable of the paper is *the weight of the ECB in EU macro-prudential framework*, the independent variable *is the Bank's position in between financial markets and the political world*, the intervening variable is *the financial crisis* and the mechanism working on the variables is the *strategic selection of ideas.*

Two hypotheses are developed in this paper to explore these variables.

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- The Bank was able to diffuse its ideas thanks to its strategic positioning in between financial markets and policy-making and to its tactics of activation/deactivation of the ordo-liberal paradigm.

The first part of this paper is focusing on the links between systemic crisis, financial regulation and uncertainty, and on how the literature deals with these three themes. To do so, the mechanisms of a systemic crisis are reviewed (1.1), then the impact of uncertainty on ideal causality and institutional change is scrutinized, mainly trough International Political Economy (IEP) literature and Historical Institutionalism (HI)(1.2), and it ends with the study of the historical variation of the Central Banks' place in financial regulation (1.3).

The second part is studying the mechanisms underlying the ECB's move on macro-prudential supervision. It is resuming the creation process of the ESRB(2.1), then on the strategic activation/deactivation of ordo-liberal paradigm (2.2) and finally on the exploitation of material resources and advantages towards other EMU's actors (2.3)

The third part is looking at the future and tries to guess some consequences of the architecture of the ESRB. The paper will then speculate on whether the ESRB could be a "Trojan Horse" for the ECB to take charge of the whole banking supervision and macro-imbalances issue within the Eurozone (3.1) and on the EU statistical production (3.2).

The methodology used is two-folded : an analysis of primary and secondary sources (EU institutions' official documents, financial newspapers articles, economy and political sciences articles and books), and 30 semi-conducted interviews conducted in the context of my PhD in

Bruxelles and Frankfurt from April to December 2010. The interviewees were high-officials[8] from EMU institutions : European Commission, European Parliament, ECB, national permanent representations and the European Council and its committees (more specifically the European Financial Committee and its alternates). One of the main flaws of the interviewees sample is that I could not conduct any with ESRB agents, or its secretariat, neither with one member of the Delarosière group.

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I) Financial regulation, systemic crisis and uncertainty

a) The notion of systemic crisis

A systemic crisis is the triggering of a systemic event following a systemic risk. There are two types of systemic events in finance[9]. The first one is very close to the "domino effect" : a sudden shock or a bad news related to one or many financial institutions spreads to other markets. The second type is when a macro-economic shock is affecting all the financial markets at the same time. The definition of a systemic risk could thus be the 'eventuality of an uprising of a certain economic configuration where rational answers of individual agents to the risk they perceive, far from helping to a better risk-sharing by diversification, contribute to accelerate the general insecurity[10]'. This definition is helpful since the risks affecting the agents is not purely exogenous : it is dependant of the perception of their mutual actions[11], and thus is socially constructed. Next, we explore their economic mechanisms, even if it is difficult to develop one single model of a systemic crisis causes and developments, as they are all *singular events*,

First, the "domino effect" is impacting on loans and payments that banks are doing between themselves : if Bank A failed to make a payment to Bank B, this one might not be able to solve its own obligations to Banks C or D, and so on…This "breaking of chains" triggers a lack of certainty of settlements within the payment system. Complexity of financial markets and the robustness of payment systems make this kind of crisis less likely today. Indeed,

[8] My interview guide was mainly shaped around that specific particularity. For further references on interviewing high-officials, Cohen S.(1999), Leech Beth (ed.)(2002)
[9] De Bandt and Hartmann, 2000
[10] Aglietta Michel (2005)
[11] This point will be developed more thoroughly in the next section.

financial institutions are not immobile and inactive : they will act in reaction of the unfolding of such events and worsening the crisis by sparking asset prices spirals[12]. As the Banks do not trust themselves anymore, they are cutting the loans they are doing between themselves, then start to lack sources of alternative funding, an so sell their assets at low-prices since there is reimbursement time-constraints and margin calls following the depreciation of collaterals. The individual rationality starts to be a collective disaster here : the action of each bank to cut loans is prudent management in case of an uncertain environment, however, it is this very phenomena, repeated by other actors, which causes the asset-prices spiral. The fear of the drying-up of the liquidity is triggering many self-enforcing effects which are leading to the effective drying-up of the liquidity : Banks will not lend their money on the interbank market but will increase their deposits at the Central Bank, will redistribute their porto-folio or fly-towards-quality.

One could develop a ideal-type of a perfect crisis[13] where all adverse factors come into interaction to illustrate these mechanisms. Bruner and Carr were writing about the "perfect storm of 1907 :

> It begins with a highly complex financial system, whose very complexity makes it difficult for anyone to know what might be going wrong; by definition, the multiple parts of the financial system are linked, which means that trouble in one institution, city, or region can travel easily and quickly to others. Buoyant growth in the economy makes the financial system more fragile, in part due to the demand for capital and in part due to the tendency of some institutions to take on more risk than is prudent. Leaders in government and the financial sector implement policies that advertently or inadvertently elevate the exposure to risk of crisis. An economic shock hits the financial system. The mood of the market swings from optimism to pessimism, creating a self-reinforcing downward spiral. Collective action by leaders can arrest the spiral, though the speed and effectiveness with which they act ultimately determines the length and severity of the crisis.[14]

The similarity of the 1907 and the 2008 crises is striking and is showing that one should pay attention to the political context as much as the economic mechanisms at work within the crisis.

[12] Schooner and Taylor (2010), chapter 3
[13] Bruner Robert and Carr Sean (2007)
[14] Ibid, pp 152-153

Facing these risks, authorities trying to stop the contagion are referred as the "financial safety net" and they are trying to build "defense lines" to help market participants to find back confidence in each other. The first line is the role of the lender in last resort, "a bank that has the ability to create new bank reserves and to lend them to commercial banks". The second line of defense is to organize a pool of actor that can guarantee that funds will be repaid in case one bank fails, the last one is a government bailout.

The role of the lender of last resort was described in the seminal book of Bagehot (1877) thanks to his distinction between an illiquid and an insolvent bank (due to the quality of assets a bank owns). To the illiquid bank, he proposed to lend money at a high interest rate against good collaterals. Insolvent institutions should be sold to new owners and be recapitalized. In contemporary financial markets, the instability is not linked to one bank but to the liquidity of financial markets. The action of the lender in last resort is thus more a monetary policy matter in stressful time than a direct intervention towards a specific bank. It has three objectives : to safeguard the system of payments as a public good (as shown in the Fed intervention on the markets after 9/11 and the breakdown of communication lines), to restore the confidence in financial markets (as shown in the ECB interventions during the Greek budget crisis) and to avoid credit restrictions in the downward phases of the financial cycles (as shown in the Fed interventions in between 2001 and 2003).

However, this safety net could create "moral hazard" : knowing that they will be bailed-out, institutions could take risks that they would not have taken otherwise and impact the stability of the financial system. There is thus a need to regulate the financial system in order to avoid this to appear. The "efficient markets school[15]" challenged this explanation and argues that it is this very regulation that destabilize market participants expectations and thus create instability. The 2007 global financial crisis challenged the 20 years' domination of this school in the field of financial theories.

b) Uncertainty and change

As Lord Turner[16] points out, "The predominant assumption behind financial market regulation – in the US, the UK and increasingly across the world – has been that financial

[15] Schooner and Taylor (2010) include economists such as Milton Friedman, Merton Miller, Eugene Fama and Alan Greenspan in this one.
[16] Chairman of the FSA

markets are capable of being both efficient and rational and that a key goal of financial market regulation is to remove the impediments which might produce inefficient and illiquid markets[17]". However, in the light of the financial crisis, "Given this theory and evidence, a reasonable judgement is that policymakers have to recognise that all liquid traded markets are capable of acting irrationally, and can be susceptible to self-reinforcing herd and momentum effects[eg : phenomenas of financial bubbles or "over-shooting"][18]".

The FSA was pointed out as one of the actors responsible of the crisis, due to its very light regulation politics towards the financial system. The fact that its newly appointed chairman clearly states that markets can be irrational represents a U-turn in financial regulation paradigme. Indeed, schools of thought claiming that markets can be subjects to irrational momentum effects, gained more importance. They are two main approaches in this school which are following the classic distinction of Knight between risk (which can be quantify in forecasts) and uncertainty (which is immeasurable and cannot be predicted)[19] : one believes that markets agents, in case of unfolding of extreme events, are irrational and following their emotions[20] ; and the other one states that even though agents are rational, they rely on data that they know is not trustworthy, uncertain or incomplete and thus, future cannot be predicted[21]. The paper will develop here the arguments of the second school and goes on with the IPE literature which is inspired from this work. First, Minsky (1986) adapts the cyclic approach of Schumpeter to financial markets stability and, demonstrates that instability is inherent and fundamental to our current economic organization because of the self reinforcing dynamic of speculative corporate finance, decreasing debt quality and triggering economic volatility[22]. Second, in his General Theory, Keynes (1936) compared financial logics with newspapers' beauty contests where the winning tactics is not to find who has the prettiest face but "to anticipate what average opinion expects the average opinion[23]".Asset prices are thus not driven by rational assessment of the information (even though actors are still rational) and an endogenous effect of asset-price growth can appear, when market participants try to bet on

[17] FSA (2009), p.39
[18] p.41
[19] Knight Franck (1921)
[20] Kahneman, Slovic and Tversky(1982), Shiller Robert (2000), Lordon Frédéric (2010)
[21] Keynes John Maynard (1936), Ellsberg Daniel (1961), Minsky Hyman (1986), Mandelbrot (1997)
[22] Sornette (2003) proposes an alternative and interesting explanation, claiming that market crashes exemplify in a dramatic way the spontaneous emergence of extreme events in self-organizing systems.
[23] Quoted in FSA (2009), p.40

what the market desires[24]. However, the future evolution of prices might be blurred in case of a uncertain context. In this one, decisions about the future are difficult since it is very hard to establish reliable forecast about market evolution (what Ellsberg calls ambiguous probability, probabilities with low weight for Keynes or wild risks for Mandelbrot). To conclude, assumptions that markets developments are both unstable and uncertain are much more recognized in economic theory today than before the 2007 global financial crisis.

Based on this body of work, IPE scholars claim that uncertainty triggers moments where agents' interest and world's perceptions are questioned and then, institutional change is more likely. Indeed, in his seminal book, Marc Blyth describes crises as "situations regarded by contemporary agents as unique events where the agents are unsure as to what their interests actually are, let alone how to realize them[25]". One theoretical consequence of this assumption is that instead of looking at agent's interests as an independent variable, one has to try to explore what causes their variation. Moreover, a crisis is not an obvious phenomena, they are socially constructed, framed, and they need to be explained. According to Hay (1999), the mobilization of the perceptions of a crisis implies the formation and triumph of a simplifying ideology which must resonate with many individual experiences. The diagnostic of an event as a crisis by a specific set of ideas is thus a construction that explains the uncertainty felt by the agents and offers a range of solutions to it[26].Economic ideas are thus powerful from a causal point of view as they define proper economic interrelations, realign agent's interest and beliefs, triggers self-fulfilling prophecies[27] and *precedes the creation of institutions.* The last point might be the most important here, as Blyth says elsewhere : "structures do not come with an instruction sheet[28]". The change of policymakers' beliefs on markets stability[29] precedes thus the institutional reconfiguration of prudential financial supervision in Europe.

It is worth to notice that ideas do not float in the air : they are sponsored and carried by actors who need a certain degree of empowerment to make these ideas matter[30], IPE scholars try then to take seriously both the importance of ideas and the power-related positions of actors in

[24] Godechot Olivier (2001)
[25] Blyth Marc (2002), p.9
[26] Blyth Marc (2002), p.10
[27] On the performativity of economic ideas on economy : Mackenzie Donald, Muniesa Fabian, Siu Lucia (2008), Callon Michel and Koray Çalışkan (2009)
[28] Blyth (2003)
[29] Exemplified above but also in may texts claiming that the subprimes crisis represents a « Minsky moment » as in Fisher (2010)
[30] Parsons Craig (2002)

an approach coined "agent-centered constructivism[31]". This approach emphasis three study points : turning points, persuasion[32] and elite-mass interaction. Actors try thus to " consider what ideas will be persuasive and establish institutional and political support for ideas to translate into policy action[33]".

It would be beneficial to bridge this approach with Historical Institutionalisms scholars who are taking ideas seriously such as McNamara (1998,2006), Jabko (2006) and Beland (2009). Their common effort to take seriously both actor power-games and the specific effects of the ideal dimension results in the study of processes such as the impact on Kingdon's problem, policy and political streams, the enablement of a wider actor's coalition, and reducing uncertainty by framing problems and solutions. It is worth to note that ambivalence is often underlying a set of ideas, which enable strategic actors to form coalitions such as the Commission did with the idea of market to deepen European integration (Jabko 2006), or the creation of competitive liberalism that was the theoretical framework of the EMU (McNamara 2006). Ideas can then be used to reinterpret the same political object differently according to the interests of each actors[34]. Institutions are shaping the use of ideas too, since the persuasion ability of technical discourse varies according to the places of its diffusion : it is more likely to be powerful within forums (spaces of debates such as ECOFIN committees) than arenas[35] (spaces of negotiation). This paper will state as well (part 2.2) that the Bank will activate or deactivate certain dimensions of the ordo-liberal paradigm according to its strategic interests, and thus emphasizes the "flexible use of ideas". Indeed, the ECB is using ordo-liberalism assumption to frame its credibility towards markets but deliberately ignores that the same paradigm does not recommend a central Bank to be involved in financial supervision as it might blur its responsibilities (cf.supra).

It would be beneficial to add to this theoretical framework the work of Dobry (1992). He points that moments of crisis are "moments of truth" in our society, when its different components exhibit their deepest and most hidden features and their most surprising resources. However, critical states of social systems do not only show their original features

[31] Widmaier Wesley, Blyth Marc, Seabrooke Leonard (2007)
[32] Defined here as "an ongoing process in which the legitimacy of claims about ''what is to be done'' is open to contestation between elites, and between elites and mass publics", Widmaier Wesley, Blyth Marc, Seabrooke Leonard (2007), p.754
[33] Ibid.
[34] Palier Bruno et Surel Yves (2005)
[35] The distinction between forum and arena is coming from Jobert Bruno (1994)

but carries their own dynamic towards the previous systemic configuration. Three factors strengthen this self-dynamism : 1) political resources' value vary in times of crisis, 2) stakes are more mobile and less easy to control and 3)social games are simplified and some actors excluded.

The two hypotheses of this paper are based on these approaches :

- Since financial crisis are unique events, agents are unsure of their interests and institutional reconfiguration is more likely. The ECB was thus a political entrepreneur, framing first the debate, and then proposing institutional solutions to address the identified problems.

- The Bank was able to diffuse its ideas thanks to its strategic positioning in between financial markets and policy-making and to its tactics of activation/deactivation of the ordo-liberal paradigm.

c) The state of financial supervision in Europe.

Financial supervision is the activity aiming at ensuring compliance of market participants with the rules (financial regulation). It has thus a executive and judiciary (as opposed to legislative) nature and looks to implement and enforce the rules. Financial regulation and supervision developments are strongly linked with crises, this section will briefly state the framework existing before the crisis and to road taken by the EU since then.

When the euro and its central bank were created, it "naturally leads one to ask whether supervision should remain national or become itself European[36]". The nature of supervisory institutions is not only determined by this question, as two other interrogations structure the debate : 1) Should financial supervision be enshrined within central banks or independent agencies? 2) Should these agencies be unified under a single one, or should they be split according to the financial sectors they supervise?

Before the financial crisis, the EU framework was set up as follows : 1) essential EU harmonized regulation; (2) mutual recognition of nonharmonized, national, rules; (3) national competence for supervision in the implementation and enforcement of the rules; and (4) close

[36] Padoa-Schippoa Tommaso (2004), p.111

cooperation among national authorities[37]. The reforms and adjustments of this framework through time did not change its main essence : supervision remains nationally based, while coordination efforts are made at the EU-level. EU financial supervision reforms have lagged despite the success of single market unification since 1992. However, the 2004 reform has established a multi-level framework, following the advices of a group of wise men chaired by A.Lamfalussy in 2001 and endorsed by the Council in 2003[38]. Coordination of national supervisors took place at the so-called "level 3 comities" aiming at "fostering supervisory convergence and best practice, principally through the creation of (non-legally binding) guidance" (FSA 2011).

To complete the picture of financial supervision in Europe, one has to focus on the nature of supervisory structures at the national level. The first element to note is their diversity : there is no one single model of financial supervision in the EU : some countries have a single integrated supervisor (such as the UK), some have a different supervisor for each sector and finally the weight of central banks on Bank and financial intermediaries' supervision vary[39]. The place of central banks in the supervision framework has been endangered by the rise of the single financial authority (such as the FSA). Two main arguments were put forward to explain the creation of such agencies : "the blurring of boundaries between financial products and services and the formation of financial conglomerates that needed to be regulated from a groupwide perspective in respect of their financial soundness[40]". Moreover, "the late 1990s and early 2000s provided evidence of a global trend toward the creation of single regulatory agencies[41]". This can be exemplified by a remark in the Lamfalussy report :

"[I]f the full review were to confirm in 2004 (or earlier as the case may be) that the approach did not appear to have any prospect of success, it might be appropriate to consider a Treaty change, including the creation of a single EU regulatory authority for financial services generally in the Community. "[I]f the full review were to confirm in 2004 (or earlier as the case may be) that the approach did not appear to have any prospect of success, it might be appropriate to consider a

[37] Padoa-Schippoa Tommaso (2004), p.108
[38] For an analysis of this process : Quaglia (2007), quaglia (2008)
[39] To see a resume of this patchwork Padoa-Schippoa Tommaso (2004), p.112
[40] Schooner and Taylor (2010), p.265
[41] Ibid, p.267

Treaty change, *including the creation of a single EU regulatory authority* for financial services generally in the Community[42]".

The rise of a European integrator would have mean the dismissing of central banks responsibilities in financial supervision. It can be proved by the ECB's attitude towards Lamfalussy reforms : they tried first to oppose the reform before pushing for national central bank's presence in the different levels of the Committees[43]. Three main reasons[44] have been advanced in the economic literature for the progressive withdrawal of supervisory responsibilities from central banks. First, there might be a conflict between macro-economic goals and micro-economic goals : the Bank's priority towards price stability might be blurred by banks supervision[45]. Then power concentration might be exacerbated if the same institution combines monetary and supervisory tasks, in case of supervision failure, its reputation and credibility towards markets might be endangered as well. Finally, its independency from political powers might be unsuitable in regards with democratic checks and balances that are associated with supervisory functions.

Against this background, the financial crisis gave a significant turn to the orientation of supervisory framework in the EU. Theoretical dimensions of the impact of the crisis have been already tackled above and the next part of this work explores the reform process in the EU since the crisis and shows how the ECB managed to gain supervision powers.

II) The ECB on the move.

A) From the Delarosière group to the implementation of the European System of Financial supervisors (ESFS).

This part seeks to indicate the main landmarks of the EFSF creation and the actions of the involved EU institutions during this process. The reasons explaining the come-back of central bankers in the ESFS are dealt in the next part. In October 2008, following the collapse of Lehmann Brothers, José Barosso gave the task to Jacques de Larosière and 8 "high-profile experts" to "give advice on the future of European financial regulation and supervision[46]". Three reasons could explain this particular choice of the Commission : 1) It is part of the

[42] Quoted in Lastra Rosa (2003), p.5, I underline
[43] Quaglia (2007)
[44] They are taken from Schooner and Taylor (2010), Chapter 15
[45] Di Noia and Di Giorgio, (1999).
[46] De Larosière (2009), p.3

habits and strategies from the Commission to delegate these missions to experts' groups, the success of Lamfalussy report showed that it could be a winning strategy, 2) The Commission was weakened at that time by the unpopularity of the Internal market commissioner (Charlie McCrevy) who was a supporter of "light-touch regulation", 3) There was a need to bypass the usual legislative process since the preparatory committees of the ECOFIN council were unable to find a consensual framework as shown by this interviewee excerpt : "everybdoy realised that sometimes we get stuck down in national dogma, and sometimes you need to bypass the national dogma, with the group of wise men, and things got down we would not have managed[47]".

The De Larosière group was already over-numbered by central bankers : 5 out of 8 were holding high-level functions in a central bank during their career. They started their work in mid-November 2008 and handed their report on the 25th of February 2009, gathering views of many officials during that time[48]. Their conclusions could be summarized as following : First, the report recommends the introduction of macro-prudential supervision since the crisis showed that micro-focus of national institutions were not sufficient to reach financial stability. This task is assigned to the ECB. European Supervisory Authorities are to be created instead of the former level 2 Lamfalussy commitees, they will have the task to ensure a common approach and settle possible arguments between home and host supervisors. It is interesting to note that as soon as the group was constituted, the ECB claimed for macro-prudential supervision responsibilities (including supervision over trans-border financial conglomerates) in a clear and bold way (which is quite uncommon in the world of central bankers) and even asked for involvement in micro-prudential college of supervisors[49]. However, the De Larosière group did not recommend to delegate micro-prudential supervision to the ECB, essentially for reasons of political feasibility : it would be too much of power delegation towards an unelected body[50]. In a communication in March, the Commission declared that it will adopt the recommendations of the report. In May 2009, the main dispositions of the report were put in the Commission's proposals which were endorsed during the European Council of June 2009. Howarth and Sadeh(2010) shows that positions of governments were surprisingly similar as there was no single EU-level supervisor, neither pooling of taxpayers'

[47] Interview A, Bruxelles, October 2010
[48] The list of official interviewees is on the annexe 3 of the report.
[49] This position is summarized in Begg (2009), p.1119
[50] Ibid

funds to a supra national institution[51], there was no agreement on the transformation of committee into supervisory authorities, but the principle of the ESRB was acted. The process followed then the legislative way, the Parliement fought back against the limited proposals of EU governments, reintroduced the three agencies and gave its green light on the 22th of September 2010. The European Council adopted finally the legal text to establish the ESRB and the three authorities and the legislation entered into force on the 16th of December 2010.

B) The strategic activation/deactivation of the ordo-liberal paradigm.

The danger of a process-tracing approach, such as this one, focusing on a specific timeline and geographical space is that the unfolding of events and the creation of the ESRB seems to be the natural best choice from all the solutions that were available out there. However, two brief examples show that this assumption does not fit with reality. The first one is the proposal of a single European regulator by the first wise men committee chaired by A.Lamfalussy (as seen above) and by the Turner report, later in 2009. The second one, is the creation of the Financial Stability Oversight Council in the USA which aims as well at identifying macro-systemic risks. This council, very similar to the ESRB, is nonetheless chaired by the Secretary of Treasury, the Fed chairman, being just one of the 10 voters. This possibility that something else could have been done has been confirmed by an interviewee from the Commission : "The macro-economic design was a bit of a easy solution, we could have chosen something else, an integrated regulator for example, it was the Finnish and Dutch proposals[52]".

The question this paper seeks to answer now is thus : why central bankers are the clearest winners of the financial supervision reforms?

The paper will argue here that the strategic activation/desactivation of the ordo-liberal set of ideas has been key to understand this change.

1) Strategic deactivation

The main obstacle for the ECB to gain these new competencies was that legislative actors could have believe that 1) it would have endanger its main objective of price stability and 2) that the ECB would not be enough cooperative because of its strong position on its

[51] Howarth and Sadeh (2010), p127
[52] Interview B, Bruxelles June 2010

independency. These two assumptions are deeply rooted in ordo-liberal paradigm and deserved the ECB's will to gain macro-supervision powers.

First, the Bank strongly defended that there will be no compromise on its traditional missions as shown by its additional proposal on ESRB status :

"The ECB has decided that it stands ready to ensure the Secretariat of the ESRB and to support the ESRB. The support provided to the ESRB by the ECB as well as the tasks conferred upon the ESRB must be *without prejudice to the principle of the independence of the ECB in the performance of its tasks pursuant to the Treaty*[53]".

Furthermore, there was no reference to the economic debate on whether new supervisory tasks could undermine the Bank's reputation and independency in the ECB officials speeches and interviews. This fact has been underlined by one interviewee : "By the way, on the macro-economic aspect, it is not without risks to step up as they did. It's even very risky, if the ESRB does not detect a big risk, it will damage their reputation. So, there was a big risk on their reputation, and they went on anyway, they took their responsibilities, the ECB is not shy, it is an institution that wish to expend its power[54]".

If this sentence might sound usual, it is worth to notice that for years, the literature analyzed the ECB as locked on the Bundesbank model[55]. The fact that the ECB decided not to take into consideration what was considered by the Bundesbank as a central bank, is thus not banal. There is here a clear break from Bundesbank's path dependency shown by the fact that the Bank just put aside one of the theoretical assumptions of ordo-liberalism. This possible undermining of Bank's credibility and blur between supervisory and monetary policies were nevertheless the reasons of the Dutch and Finnish positions towards the creation of an independent regulatory body. The Bank even started to link the objective of financial stability to the one of price stability for the first time since its creation in December 2008 in its introductory sentence of its monthly press conference : "The Governing Council will continue to keep inflation expectations firmly anchored in line with its medium-term objective. In so doing, it supports sustainable growth and employment and contributes to financial stability[56]".

[53] ECB (2009), I underline
[54] Interview C, Bruxelles, May 2010
[55] Dyson and Featherstone (1999), Howarth (2006)
[56] Trichet (2008)

It is interesting to note that financial stability substitutes exactly “purchasing power” which was included in this sentence, that is repeated in each monthly press conference, before the crisis.

To a slighter extent, the ECB deactived certain features of ordo-liberalism by being less harsh on its independency. Indeed, too many reminders of this status might have been counterproductive as shown by an interview with a member of the Commission :

> “The ECB often has a ayatollah behavior on some subject that is very tiring. They are behaving a bit with a Dutch protestant ethic : “I’m in my moral right even if the world crumbles around us”. There is often a lack of pragmatism, they are looking for purity when they are immersed in a world which is consensus-based[57]”.

The same interviewee notices a bit further that tensions do not happen with the DG responsible for macro-prudential issues at the ECB, and so relations are good. He notices however that if it would have been populated with “little clones of Stark[58]”, the position of the Commission would have been more problematic. Moreover, the Bank wanted to gain control over crossborder financial conglomerates, which the Commission did not want to include since the ECB must still prove it can act as a cooperative actor.

2) Strategic activation

Even though some features of ordo-liberalism might have undermined the Bank’s position and thus needed to be deactivated, the ECB was still keen to remind its past record of “responsible Bank devoted to price stability”. First, an interviewee at the Commission notice that “they stayed within their mandate which is price stability, if you are looking at Trichet speeches, he is talking since a long time about housing and asset bubbles, they lowered their interest rates, some say it was “too late”, pff they can say it, but people were enthusiastic about Greenspan’s politics, now it is the opposite[59]”. This was confirmed by one member of the Ecofin Council committees :

> “Also with the crisis, when central banks being such an integral part of the solution but not of the problem, they have legitimacy which governments do not have to do that, so it was unavoidable and inescapable.[…] So, who's got the credibility? The ECB, because they got people who were so unpopular like

[57] Interview B, Bruxelles, June 2010
[58] One of the board member of the ECB, who has a strong hawkish reputation.
[59] Interview D, Bruxelles, May 2010

> J.Stark, Jurgen will stand in front of you and say this is a catastrophe, this is the wrong you have totally made a mess of it. Commission will say ahhheeu, tsa tsa tsa. Good thing we kept the European Parliament out, it would have been a real mess, a real mess. So, all these things add up, the ECB in two years they can sit back and say "this has been a really good crises", This is the greater strengthening of European Central Banking since I don't know...Adam Smith[60]"

Stability-oriented politics legacy have thus been activated by the ECB to present itself as the most credible EU institution to chair the ESRB. "Early" recognition of risks towards financial stability due to the development of new financial instruments, and the existence of its "two-pillars" strategy (the ECB has kept a monetary pillar in its assessment of economic developments which was inherited from the Bundesbank and has been dropped by many other Central Banks), were two valuable proofs that the ECB was not overcome by the events but worried about financial stability risks.

This hard-fought-gained credibility and reputation towards financial market is necessary for the ESRB as it only has the instrument to deliver recommendations and doesn't have thus binding mechanisms. The fact that the ECB is listened by financial markets, allow thus to "import" its credibility within the ESRB : market participants are expected to recognize the ECB expertise and comply to its notifications since it might be dangerous for their reputation to undermine them.

The last feature of ordo-liberalism that was activated by the ECB is the importance of its independency, indeed the vast majority of EU actors did not consider the ECB as motivated by political gain and was just facing its treaty-driven responsibilities[61] as shown in this ECOFIN member interview[62] :

" The Commission is seen as a political body by many when the ECB is more an expert, people don't doubt their position, they don't see a political interest behind it, when they talk, it's closer to the truth. Moreover, the ECB always rally a certain group of countries with them"

Even though a Central Bank is part of the political game by definition, a member of the Commission points out that they "sacralized a bit too much this concept of Central Bank's

[60] Interview A, Bruxelles, October 2010
[61] Articles 105 (4) and 105(5) of the Maastricht Treaty.
[62] Interview E, Bruxelles, November 2010

independency[63]", his point of view is, however, not shared by a majority of actors as exemplified by this Ecofin member :

"The most important reason is the idea that the ECB is independent, lot of institutions are independent, but the ECB is the most independent, you cannot accuse them of any collusion...there is the idea that if the ECB is saying that, it is true, it is an opinion without pressure from the governments, it is the right figure, there is a sure effect of this aura of independence[64]"

Basic assumptions of ordo-liberalism (Price-stability orientated policies, Central Banks independency, credibility towards financial markets as monetary policy transmission mechanism) were thus activated by the ECB to overweight the ESRB. It is indeed surprising that there is no real representation of fiscal authorities within this one[65]. However, this strategy based on activation/deactivation of ordo-liberalism assumptions would not have worked if the ECB was otherwise not a powerful actor with the most adapted resources, amongst other EMU actors, for financial supervision.

3) Harder, faster, better, stronger

The first point one needs to underline is the time-control ability of the Banks. Indeed, its agents have the knowledge and the skills to manage financial market's pace. As one agent of the ECB says :

"Let's say that other institutions have sometimes an attitude on which they ignore the markets, the last speech of Merkel for example showed that they don't understand this logic, or let's say that they understand less the meaning of financial market discipline. As well, the link between fiscal policies and financial stability has been understood faster by the ECB[66]".

This is confirmed by one member of the Ecofin council : "The ECB was at the center of the project since it was the most responsible institution during the crisis and they were able to act faster and react faster than everybody else[67]". The ability to react to market tensions in "real-

[63] Interview B, Bruxelles, June 2010
[64] Interview F, Bruxelles, November 2010
[65] Buiter (2009)
[66] Interview G, Francfort, December 2010
[67] Interview E, Bruxelles, December 2010

time" was due to its very nature of money-supplier and was used as an argument to manage the ESRB.

Moreover, the ECB has the complete control over its budget : it does not need to open budget lines and ask the authorization from member states and is less constrained that the Commission, which is another independent body. It was then much easier for the Bank to host the secretariat of the ESRB, even though it needed a reallocation of resources, staff and research priorities.

Finally, research capacities have been strongly highlighted by the Bank which embodies the most extended research center amongst EU institutions : the Commission could be their only concurrent but did not develop the same expertise towards financial markets (they created a new body following the crisis, but its staff is limited to 15 agents). Indeed, financial supervision needs an efficient data gathering and analysis ability (the ECB is the only provider of European statistics with Eurostat). This advantage has been heavily exploited by the ECB, as they were highlighting this expertise ability in each official speech[68] during the creation process of the ESRB.

The ECB had thus material and ideal resources they were able to exploit in order to get its new supervision powers : they managed to give to the Bank a picture of an independent, credible and expert institution. However, as expertise is often another way of doing politics[69], the last part of this paper seeks to analyze the possible political consequences of the creation of the ESRB.

III) Exploring possible unintended consequences of the ESRB

In social sciences, we can understand the past, explains the present but not predict on the future[70]. However, we try to interrogate ourselves on whether the ESRB could be a "Trojan horse" for a further expansion of ECB's competences. To do so, this paper explore the possibilities of an approach by the instrumentation developed in public policy studies[71]. This

[68] See Begg (2009)
[69] Radaelli (1999), Robert (2010)
[70] Favre (2005)
[71] Kassim and Legalès (2010)

approach highlights the importance of studying unintended effects of the implementation of an instrument on power relationship in between actors. Indeed, the ESRB might change the position of the ECB within the EMU as it is possible to imagine an extension of its competences towards both banking and economic macro-imbalances realms. There might be as well an extension of the ECB's competences in the field of statistic production, as it is a domain shared with Eurostat, and on which the ESRB statistical needs are important.

1) Imbalances, banking supervision and the ESRB.

a) One of the answers of the Commission to the crisis is the reinforced economic governance in the EMU (outlined in a communication the 12th of May 2010, a concrete toolbox has been presented on the 30th of June and a package of legislative proposals on the 29th of September). In these texts[72], the Commission points the issues that have to be tackled such as macro-economic imbalances and losses of competiveness between countries. They proposed then a scoreboard based on a set of indicators[73] from which "the Commission will draw a list of Member States deemed at risk of imbalances[74]", an excessive imbalance procedure and finally an enforcement mechanism decided by the Council. What is interesting for us here is the proximity of these propositions with the way that ECB members are defining ESRB missions and responsibilities :

> "Vítor Constâncio, ECB vice-president who will sit on the board, told the Financial Times: "If there were *serious economic imbalances in a member country* we [the board] could say that something should be done about it."
> Mr Constâncio said the systemic risk board could have sounded warnings at an early stage about the problems in Greece – *where loss of competitiveness* led to a surging current account deficit.
> "We could also have warned about housing market bubbles in Spain and Ireland – and about lending in foreign currencies in eastern Europe," he said. "These are examples of things that the ESRB would have done to prevent crises. If a body such as the systemic risk board, with so many members, issues concrete recommendations of that sort, then something would have to happen[75]"

Imbalances and loss of competiveness are shared objectives with the Commission's project and issuing recommendations is one of the solutions as well. What happens then in case of overlap in between these two mechanisms? The Commission proposals state that

[72] Commission (a) and (b) (2010)
[73] As shown in the next part of this paper, these indicators might be produced directly by the ECB
[74] Commission (2010b)
[75] Atkins Ralph (2011), I underline

> "The Commission would take into account relevant input from the European Systemic Risk Board. Warnings and recommendations from the European Systemic Risk Board addressed to one or several Member States would be considered as a matter of common concern, while applying appropriate peer pressure for remedial action. Synergies and consistency between the different strands of economic surveillance should be facilitated by an integrated surveillance cycle under a European Semester[76]".

In clear, no coordination mechanisms (except this undefined European Semester) and duties sharing are planned, as exemplified by this interview with an ECOFIN committee member[77] :

"Q : Do you expect a potential overlap between ESRB missions and Commission's global imbalances project?

A :I asked the question yesterday to the EFC! The Commission didn't know yet how they will interact in between the ESRB and their program. I am pretty sure that the ECB will go further on issues such as wages, price formation and labor market reforms".

If this paper had to bank on the future, predictions will be these : The Commission will be able to support the ESRB in case of a common macro-imbalance view but not the opposite. The week-end of the 9th of May showed that Commission was not a actor powerful enough to shape the agenda in times of crises[78]. Moreover, the ECB will be more and more listened on subjects such as wages or labor market reforms.

b) On the issue of banking supervision, some actors think that the ESRB might be the way for central banks to get back the supervision tasks they have been asking for years :

> "With the crisis, the pendulum went right in the opposite direction and now central bank is in the midst of Banking supervision, and this is being a concerted action by euro area and specially Euro area central banks but it has been a global response. I think it will go even further, and one of the reasons, they gave for that, was macro-prudential oversight, and they said you cannot dissociate macro prudential supervision from central banking institutions, only if you got both of this in one hand, does banking supervision makes sense. *So setting up the ESRB in the ECB is just a logical consequence for what they have been preaching now for 10 years in order to get the banking supervision back*. Because if you got one, you need to take the other, otherwise the whole argument that has been carefully spread during a decade will collapse, so voila, that why the ESRB in the view of all central bankers has to be there.[...] I cannot show you the papers which are

[76] Commission (2010a), p.8
[77] Interview E, Bruxelles, November 2010
[78] Fontan (2011)

> already circulating of the first meeting of the ESRB steering committee which will happen in December. But there are full of banking supervision bla bla, the ESRB is the gateway to get all of the banking and insurance supervision under the central bank auspices. You will see in a few year time, no more independent supervision, just central banking supervision and insurances[79]".

2) Statistical production : "loop-in" effect.

Since the beginning of the debate on the ESRB, ECB board members are underlining their urgent needs to have more data on the institutions they are to supervise. Statistics might seem a minor subject, but they are subject to power struggle too, as they change the representation of the world through its practice of quantification[80]. Indeed, statistics are used to classify institutions, give objectives, compare and evaluate performances, define and enforce criteria of good governance; they are thus a source of power for the institution that is managing their production (and even more, their diffusion, cf.infra). The extension of data production, because of the new information needed to steer the ESRB, might thus be an extension of strategic resources for the ECB. Struggles in this field between Eurostat and the ECB has less impact on public space that the buying of government bonds, but are still fierce. The Bank main problematic is to access to confidential data sources but it has direct access to sources thanks to its money operations as shown in this interview with one ECB member (it is still unclear how the Bank will be allowed to use this information):

"Q:Do you have enough existing data, is there any problem to access to data for the ESRB?

A :Access is linked with confidentiality problems. But our data is better that other central banks and we have a better way to look at it. We do not share data with other CBs, data is coming from direct source (ex : during the processing of money market operation), it might be used through a case by case decision. We saw that this confidentiality was a problem when the BoE published a list of individual bank data in 2008. T2S gives more scope in terms of data as well. But we didn't resolve yet which data we will use, and how we will use it. If the question is do we need new type of data for conducting ESRB operations, the answer is yes, and we need to structure the existing data better[81]".

One agent of Eurostat analyses as well this extension of data collection from the ECB:

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[79] Interview A, Bruxelles, October 2010
[80] Desrosières (2005)
[81] Interview H, Frankfort, December 2010

> "With the ESRB, the data collected widens in two directions. 1) First *countries*, they will collect now for the whole EU27 area, and as it is dealing with financial stability, there is a need to collect data from non EU countries, maybe buy it , for example Switzerland, Norway, Japan, China, US… 2) then *areas*. They manage to include insurance, corporation, pension funds. So they will have more data since these entities are part of the reporting population now, which means that they can ask questions to these entities. It is not just linked with macro sides, They collect now data on financial conglomerates (Large Bank and Insurance Groups), this data is not coming from a single member state, they collaborate with the three other new agencies for that which will be transformed out of existing bodies, below this, there is a risk for individual bank as well, therefore banking data might be necessary in case of crisis, it is called micro data, the ECB has safeguarded that legal basis allows her to collect this data in appropriate needs. It might be contacting supervisory agencies, if nobody can provides this data, it can be collected directly by the ECB. They have the right to do so, but they might give this task to NCBs[82]"

This interviewee specifies then how the data collected might be a strategic tool for the ECB :

> "As regard with data, they are two layers : the data production and its diffusion to the public. Some ECB items are published, some not. That's where data power lies. Lot of things depends of how you reveal your data, the way of working has not been yet decided *: will they keep it secret and warn the finance ministry before ECOFIN meetings or deliver public statements*? Both ways are powerful […] The ECB has taken advantage of the crisis. In old days, you have to explain why you know something, *it is different with the crisis, when you can explain grey areas of knowledge, when you can shed light into, nobody asks where does the light come from*[83]".

The repartition of statistic production is still ongoing while writing this paper but it is safe to predict that, as Eurostat has lost credibility during the Greek budget crisis, and since the Bank usually manages to match its tools to its needs, the ECB statistical production, and power-related dimension lying through its diffusion, will extent.

[82] Interview I, Luxembourg, November 2010
[83] Ibid, I underline

Conclusion

This paper explained how the ECB gained new responsibilities through the creation of the ESRB. Special attention has been paid to the economic and political features of a systemic crisis, to the institutional position of the ECB in between financial markets and EU political decision-making arenas, and to the role of ideas and actors strategies. This paper bridges thus the IPE, HI and strategic constructivism approaches by taking into account all these variables and how they interact. The main claim here is that 1) systemic financial crisis offer more political space to actor's strategic expansion of competences (IPE approaches), 2) the ECB benefited from its past legacy of credible inflation-fighter (HI approaches), 3) it manages to strategically use this ideal dimension in a flexible way (strategic constructivism approach) and to 4) politically exploit its credibility and expertise towards financial markets. Finally, one can try to predict what could be the "spill-over" effect of the ESRB by looking at the possible future ECB's extension of competences over Commission's macro-imbalances program, EU banking supervision and data collection and diffusion.

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